



MISSOURI STATE LOTTERY COMMISSION

A Component Unit of the State of Missouri

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For the Fiscal Year Ended June 30, 2004



**MISSOURI STATE
LOTTERY COMMISSION**

A Component Unit of the State of Missouri

**COMPREHENSIVE ANNUAL
FINANCIAL REPORT**

For the Fiscal Year Ended June 30, 2004

PREPARED BY

**FINANCE AND ADMINISTRATION DIVISION
RONALD E. MURPHY, MBA, CGFM
DIRECTOR**

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INTRODUCTORY SECTION





Missouri Lottery

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November 5, 2004

To: Kenneth R. Hensley, Chairman Missouri State Lottery Commission
Mitchel Geisler, Member
Barbara H. Pickering, Member
Sue Carrol Terry, Member
Sherri Robins, Member
James R. Scroggins, Executive Director

INTRODUCTION

We are pleased to transmit this Comprehensive Annual Financial Report (CAFR) of the Missouri State Lottery Commission (MLC) for the year ended June 30, 2004. In this report we have included an introduction, our financial statements including the independent auditor's opinion on the financial statements, and statistical data relevant to the operations of the Lottery. The MLC is responsible for the accuracy and fairness of this presentation. The MLC is included as a component unit of the State of Missouri. This report presents the activity of the MLC as a single enterprise fund and does not include information related to any other state agency or fund. We trust that you will find this report informative as to the success of the Lottery as well as the challenges and opportunities that face the MLC in the future.

The Introductory Section of this report includes this transmittal letter and an organization chart denoting principal officials. The Financial Section includes the independent auditor's report and the comparative financial statements and accompanying notes. The Statistical Section contains other selected data relevant to the operations of the MLC.

Accounting principles generally accepted in the United States of America require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. The MLC's MD&A can be found immediately following the report of the independent auditors.

The MLC was created by the passage of a constitutional amendment on November 6, 1984 by the citizens of the State of Missouri. Ticket sales began January 20, 1986, with the introduction of a single scratch-off game, Jackpot 86. This represented the first legislatively authorized lottery tickets sold in Missouri since the New Franklin Railroad Lottery (later known as the Missouri State Lottery) was closed down in 1877.

The MLC is a Type III division assigned to the Missouri Department of Revenue as defined in Section 313.210 of the Missouri Revised Statutes. The Department of Revenue has no control, supervision, or authority over the actions or decisions of the MLC. The Commission consists of five members appointed by the Governor with the advice and consent of the Senate.

ECONOMIC OUTLOOK

The MLC expected continued sales growth and profitability from the continuing comprehensive product initiatives implemented in prior years and that is what happened in fiscal 2004. The online games showed an increase of over 15% over the prior year. This is due primarily to the Powerball game. The Powerball game sales are driven by the growth of the jackpot and these jackpots exceeded expectations in 2004. Scratch game sales increased by over 10% for 2004 due to expanded offering of higher price point games. Other lottery products are fairly mature, as is the case across the country, and are expected to maintain a flat to moderate growth curve.

PRODUCTS

The MLC currently offers the following games for players to choose from:

Scratcher Games are provided through a contract with Scientific Games Inc. that provides game design consultation, printing, and electronic validation information for prize payment. These games are played by scratching a latex coating to reveal the play area of the ticket. There are different ways to win including matching certain symbols, adding up to a specified total or otherwise satisfying the requirements listed on the ticket. These play styles are combined with a variety of game themes and price points. If the specified condition occurs the ticket is an instant winner. These games were the first offered by the MLC and continue to represent over 50% of our total annual ticket sales.

On-line games are provided through a contract with GTECH Corporation that maintains selling terminals at retail locations and a central processing system operated on a Lottery-owned telephone network. These games are played by purchasing a ticket from a retailer through an on-line (computerized) selling terminal. These tickets are then held until a drawing is conducted by the MLC and witnessed by independent auditors to determine the winning numbers. Drawings are conducted daily or twice a week dependent upon the game. Pick 3, Pick 4, and Show Me 5 Paydown are drawn daily and are distinguished by their play styles, prize amounts, and odds of winning. The MLC added a feature to the daily games, called Xtra, in 2004. To play this game a player must play a daily game of their choice first then choose to play an additional \$1 and win a prize instantly. Club Keno is an on-line game sold in age-controlled environments with drawings every 5 minutes. Players choose the number of "spots" they want to play that in turn determines the amount they may win. Missouri Lotto is drawn twice a week and offers a guaranteed minimum top prize of \$1 million paid over 25 years. The top prize grows for each draw that it is not won. Powerball is a lotto style game that offers a guaranteed minimum top prize of \$10 million paid over 30 years. The Powerball game is offered in conjunction with 27 other jurisdictions through the Multi-State Lottery Association. Profit for all on-line games sold in Missouri stay in Missouri.

Pull-Tabs are provided through a contract with American Games Inc. and are played by opening tabs on one side of the ticket to reveal rows of symbols under each tab. Prizes are won by matching symbols indicated on the front of the ticket. The retailer who sold the ticket pays most pull-tab prizes. The MLC has introduced pull-tab games with a top prize of \$1000 that must be paid by the MLC.

ACCOMPLISHMENTS AND INITIATIVES

- Total Sales for 2004 were \$791.1 million which is the highest annual sales in the 19-year history of the MLC
- Conversion to a computerized winning number drawing system from manual ball machines for online games in June 2004
- Development of a request for proposals for online games. A new contract will be awarded and equipment installed by July 2005.
- Begin deployment of 20 game scratcher ticket promoters that will increase product facings in retail locations

GOVERNMENT FINANCE OFFICERS ASSOCIATION CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Missouri State Lottery Commission for its comprehensive annual financial report for the fiscal year ended June 30, 2003. This was the fourth consecutive year that the Lottery has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

FINANCIAL INFORMATION

Accounting System and Policies:

The MLC uses the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under the accrual basis of accounting revenues are recognized when earned and expenses are recognized at the time of the related liabilities are incurred.

Budgetary Controls:

The MLC annually submits a request for appropriation through the budgetary process of the State of Missouri. Expenditures of the MLC are subject to this appropriation process. The MLC does use interest earnings at the Multi-State Lottery Association (MUSL) to offset certain administrative and promotional expenses. The balance of these MUSL interest earnings is transferred to the Lottery Proceeds Fund.

Expenses associated with the operation of the MLC are submitted for payment through Missouri Office of Administration, Division of Accounting. The MLC maintains its own signature authority for payment of prizes through an imprest checking account. The MLC has its own purchasing authority and has adopted the same rules and procedures as that of the Office of Administration, Division of Purchasing and Materials Management, with the exception of providing for preferences and exclusive solicitation for minority and women owned businesses.

Debt Administration:

Long-term liabilities for multi-year prizewinners are presented on the statement of net assets. The MLC holds US Treasury Strips in the name of prizewinner for the purpose of funding these payments. The MLC does own some insurance annuities to fund prizes won prior to August 1990.

Cash Management:

The Lottery Enterprise Fund is a portion of the state funds maintained by the Office of State Treasurer and as such are pooled in short term investments until needed for cash payments.

Risk Management:

The MLC major assets including buildings, data processing and other major equipment are insured by a third party carrier maintained by the Office of Risk Management. The MLC also maintains business interruption insurance. Liability indemnity for operation of the Lottery is managed through the State's Legal Defense Fund of the Office of Attorney General.

INTERNAL CONTROL ENVIRONMENT

Management of the MLC is responsible for establishing and maintaining an internal control structure designed to ensure that assets are protected from loss, theft, or misappropriation. The internal control system also ensures that the accounting system provides accurate and timely financial information. The structure does not provide a guarantee but rather reasonable assurance that these objectives are met.

To enhance controls over accounting procedures, the MLC has segregated appropriate functions where feasible, and added additional administrative reviews of areas not clearly segregated to ensure compliance with established control policies.

Section 313.315 of the Missouri Revised Statutes requires the State Auditor to conduct a biennial audit of all accounts and transactions of the MLC, and such other special audits, as it may deem necessary. The MLC is also required to employ an independent firm of accountants to conduct an annual audit of all accounts and transactions of the MLC. This audit includes a review of internal controls as they relate to the expression of an opinion on the financial statements.

In addition, the MLC has from time to time employed the services of an independent firm to conduct reviews of our security procedures for data processing and controls with on-line game suppliers.

FUTURE PROJECTS

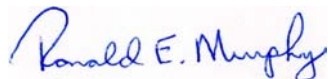
Major initiatives in 2005 and beyond include:

- Twice daily drawings for Pick 3, Pick 4, and Show Me 5 Paydown
- Convert to a new online gaming system.
- Convert to a new telecommunications network for online game terminals
- Convert scratch only retailers to full service retailers who can sell all products

ACKNOWLEDGEMENTS

Preparation of this report could not have been accomplished without the entire accounting staff, especially Larry Jansen CPA, CGFM, Controller, and Cathy Long, CGFM, Financial Accounting Manager. This CAFR represents our ongoing commitment to provide financial systems and information in conformance with the highest standards of public accountability.

Respectfully submitted,



Ronald E. Murphy, MBA, CGFM
Director of Finance and Administration
Missouri State Lottery Commission

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Missouri State Lottery Commission

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

A Certificate of Achievement for Excellence in Financial
Reporting is presented by the Government Finance Officers
Association of the United States and Canada to
government units and public employee retirement
systems whose comprehensive annual financial
reports (CAFRs) achieve the highest
standards in government accounting
and financial reporting.



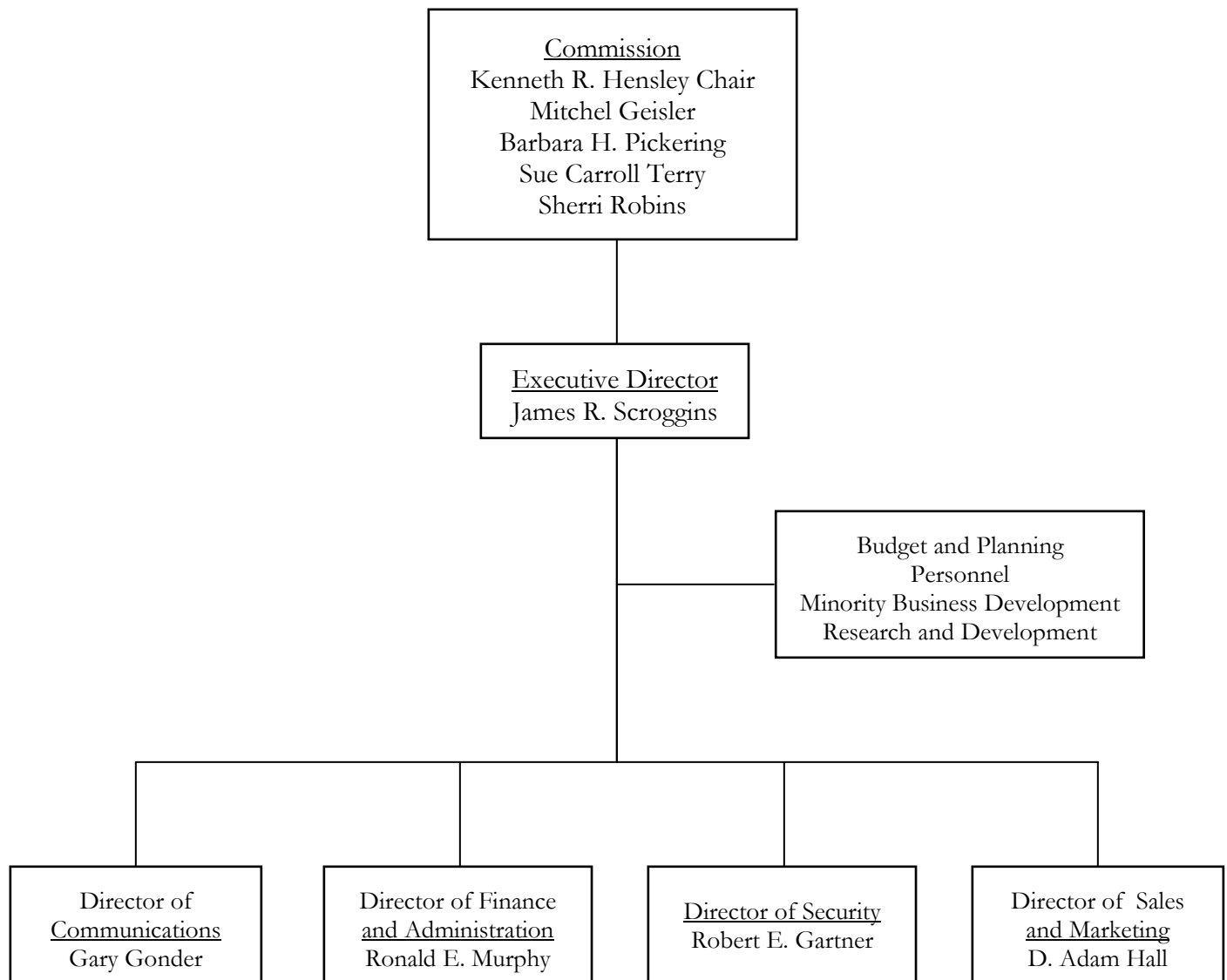
Nancy L. Zjelke

President

Jeffrey R. Enen

Executive Director

Missouri State Lottery Commission
Principal Officials and Organization Chart
June 30, 2004



FINANCIAL SECTION





Berberich Trahan & Co., P.A.

Certified Public Accountants

CH

& C

COCHRAN, HEAD & CO., P.C.

Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

To the Missouri State Lottery Commission:

We have audited the accompanying basic financial statements of the business-type activity of the Missouri State Lottery Commission (the Lottery), a component unit of the State of Missouri, as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These basic financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the business-type activity of the Missouri State Lottery Commission, as of June 30, 2004 and 2003, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 24, 2004 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 8 through 11 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements. The accompanying introductory section and statistical tables are presented for purposes of additional analysis and are not a required part of the basic financial statements. The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Berberich Trahan & Co., P.A.

Cochran, Head & Co., P.C.

September 24, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE FISCAL YEARS ENDED JUNE 30, 2004 AND 2003

This discussion and analysis of the Lottery's financial performance provides an overview of the financial activities for the fiscal years ended June 30, 2004 and 2003. Please read it in conjunction with the Lottery's financial statements, which begin on page 12. These financial statements reflect only activities of the Missouri State Lottery Commission (MLC), a component unit of the State of Missouri.

Using This Annual Report

This annual report consists of a set of financial statements. The Statement of Net Assets provides information about the MLC assets and liabilities and reflects the MLC financial position as of June 30, 2004 and 2003. The Statement of Revenues, Expenses, and Changes in Fund Net Assets reports the activity of selling lottery products and expenses related to such activity for the years ended June 30, 2004 and 2003. The Statement of Cash Flows outlines the cash inflows and outflows related to the activity of selling lottery products for the years ended June 30, 2004 and 2003. All financial information presented in this management discussion and analysis is in millions.

MLC Net Assets

	2004	2003	2002
Current and other assets	\$62.8	\$58.0	\$50.8
Non-current assets	79.0	89.8	86.7
Current liabilities	63.3	58.8	51.7
Long-term liabilities	69.3	73.0	75.4
Net Assets			
Invested in Capital Assets	4.2	5.0	5.9
Unrestricted	-4.2	-5.0	-5.9
Restricted for unrealized gains	9.3	16.1	10.3

The MLC current assets consist primarily of cash and cash equivalents with the State Treasurer, accounts receivable from ticket sellers and investments held on behalf of grand-prize winners (current portion). Non-current assets consist primarily of investments held on behalf of grand-prize winners (non-current) and net capital assets. Current liabilities consist primarily of accrued prizes payable, the amount due the Lottery Proceeds Fund, and general accounts payable to suppliers. Long-term liabilities include the long-term portion of amounts payable to grand-prize winners. Net assets invested in capital assets are unrestricted. Net assets restricted for unrealized gains on investments held for grand-prize winners are presented in compliance with GASB 31 and represent the net market value adjustment of investments held to maturity.

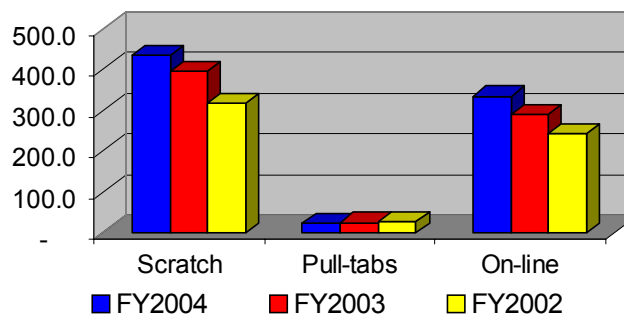
MLC Changes in Net Assets

Operating Revenues:

	2004	2003	2002
Sales by Game			
Scratch	\$434.8	\$394.0	\$316.4
Pull-tabs	21.8	25.0	27.4
Lotto	35.0	28.7	27.0
Pick 3	53.9	53.6	51.8
Pick 4	18.4	16.1	15.3
Show-Me 5 Paydown	24.3	22.7	22.7
Club Keno	51.5	42.6	3.1
Powerball	147.2	125.3	121.5
Xtra	4.0	0.0	0.0
Other	0.6	0.5	0.6

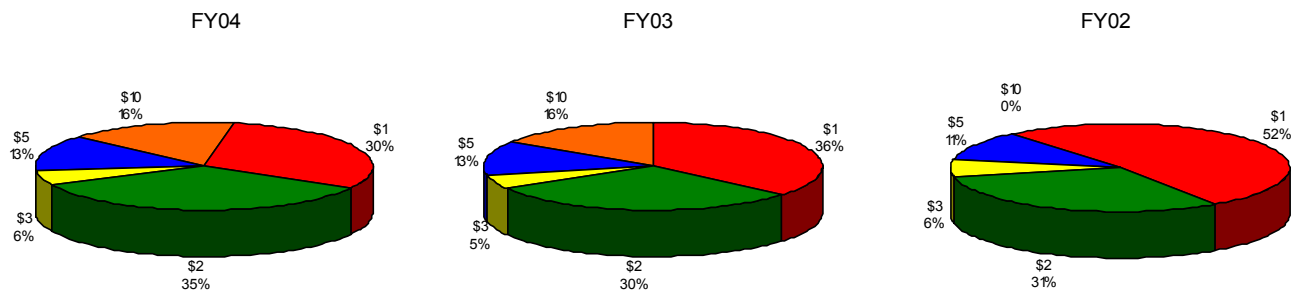
LOTTERY SALES BY PRODUCT

in millions

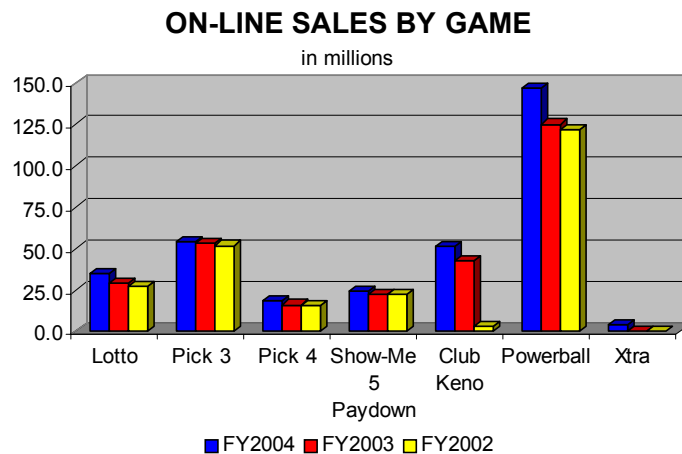


Revenues from the sale of lottery products were the highest in the 19-year history of the MLC. As indicated in the financial statements, scratch tickets led the way to this record sales level. Starting in fiscal year 2002 and continuing through fiscal years 2003 and 2004, the MLC made a significant investment in increasing prizes and introducing more \$2, \$5, and \$10 tickets. The resulting increase in the ratio of sales for higher price point games led to overall sales increases in scratch ticket sales.

SCRATCH TICKET SALES BY PRICE POINT

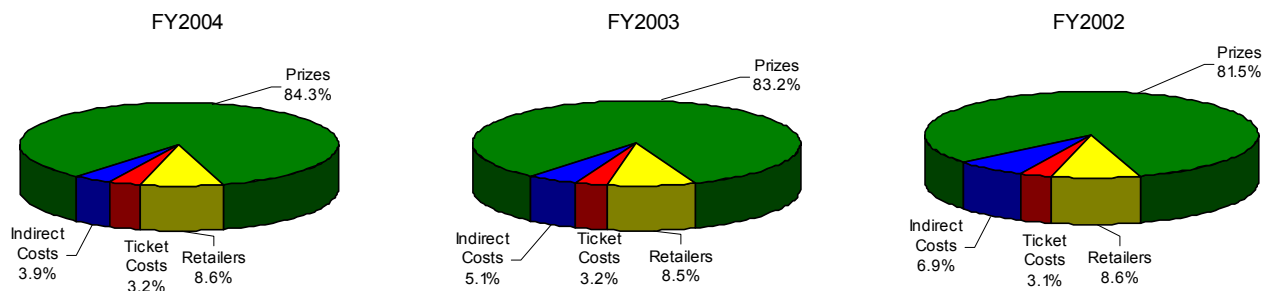


The on-line sales increases were due primarily to the Powerball game in fiscal year 2004 and to the Club Keno game in fiscal year 2003. Several large jackpots during fiscal year 2004 contributed to record sales for the Powerball game as sales are driven by high jackpot amounts. The MLC experienced an entire year of sales of the Club Keno game, which was introduced in May of 2002, in fiscal year 2003, boosting total fiscal year 2003 on-line sales. An incentive plan was instituted in fiscal year 2003 to expand the number of retailers of Club Keno game. This plan helped continue the growth in Club Keno sales in fiscal year 2004. Pull-tabs are sold in the same market environment as Club Keno and although experiencing a slight decline in sales, did better than expected. The Lotto, Pick 3, and Pick 4 games have experienced continued modest sales growth.



Operating Expenses

	2004	2003	2002
Game related			
Prizes	\$484.8	\$434.6	\$353.1
Retailer commissions and incentives	49.3	44.5	37.1
Tickets	7.0	6.5	4.8
On-line vendor fees	11.3	10.2	8.5
Non-game related	552.4	495.8	403.5
Advertising	3.0	5.6	8.1
Wages and benefits	8.5	8.4	8.4
Other general expenses	11.1	12.6	13.3



Of the MLC total operating expenses of \$575.1 million in fiscal year 2004, \$552.4 million, or 96.1%, are game related, or direct, expenses. In fiscal year 2003, direct expenses were \$495.8 million, or 94.9%, of the total \$522.2 million total operating expenses for the year. In fiscal year 2002, direct expenses were 93.1% of total operating expenses. The increase in all direct expenses is associated with the increase in product sales. Aggregate prize expense as a percentage of sales remained relatively unchanged from 2003 at approximately 61% in 2004 after having increased from 60% in 2002.

Non-operating Revenues (Expenses)

	2004	2003	2002
Interest	\$ 0.50	\$ 0.40	\$ 0.70
Unclaimed prizes	12.30	16.70	6.70
Net increase in investments held	-1.50	11.30	7.70
Amortization of grand-prize winner liability	-5.30	-5.50	-5.60
Gain (loss) on capital asset disposal	-0.01	0.06	0.10
Transfers to State of Missouri	-229.00	-203.50	-160.00

Net increase in investments held for grand-prize winners represents the net market value change as required to be reported per GASB 31. Amortization of grand-prize winner liability represents the accretion of interest to the securities held to maturity to fund the grand-prize winner payments.

All net proceeds are transferred to the Lottery Proceeds Fund for Education. Net proceeds for 2004 increased \$25.5 million, or 12.5%, over 2003. For 2003, proceeds increased \$43.5 million, or 27.2%, over 2002. The governor's office and the legislature determine where these funds will be expended within the state's public institutions of elementary, secondary and higher education. The Missouri Department of Elementary and Secondary Education was appropriated \$121.1 million in 2004 and \$118.8 million in 2003 and the Missouri Department of Higher Education received \$75.5 million in 2004 and \$74.3 million in 2003.

Economic Outlook

The economic outlook for the State of Missouri appears stable with projections for moderate growth over the next three years. However, looking at the history of lottery sales both in Missouri and throughout the lottery industry, there does not seem to be a correlation between the state of the economy and lottery sales.

A fairly stable economic environment, as well as maturity of traditional lottery products, decreasing promotional resources authorized by the appropriation process, and competition from other forms of gambling should all contribute to very modest growth in product sales over the next twelve to eighteen months.

Contacting MLC Financial Management

This management discussion and analysis report is designed to provide Missouri citizens, government officials, players, retailers and other interested parties with reliable financial information and an explanation of the MLC financial activities for the years ended June 30, 2004 and 2003. If you have questions about this report or need additional information, contact Larry Jansen CPA, CGFM, Controller of the Missouri Lottery Commission, P.O. Box 1603, Jefferson City MO 65109-1603.

MISSOURI STATE LOTTERY COMMISSION
(A Component Unit of the State of Missouri)

STATEMENTS OF NET ASSETS AS OF JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 13,043,137	\$ 10,748,318
Investments held for grand prize winners at fair value	10,515,074	10,391,411
Accounts receivable, net of allowances for returns and doubtful accounts	38,527,588	36,892,214
Other receivable	644,851	13,000
Prepaid expense	<u>90,258</u>	<u>0</u>
Total current assets	<u>62,820,908</u>	<u>58,044,943</u>
NONCURRENT ASSETS:		
Investments held for grand prize winners at fair value	74,824,261	84,851,619
Capital assets:		
Capital assets not being depreciated	352,973	352,973
Capital assets	20,680,735	20,662,099
Accumulated depreciation	<u>(16,881,986)</u>	<u>(16,028,376)</u>
Total noncurrent assets	<u>78,975,983</u>	<u>89,838,315</u>
Total assets	<u>141,796,891</u>	<u>147,883,258</u>
CURRENT LIABILITIES:		
Accounts payable	412,294	289,251
Due to Lottery Proceeds Fund	18,214,452	18,602,068
Accrued prize liabilities	31,167,766	26,806,489
Grand prize winner liabilities	10,584,000	10,434,000
Other accrued liabilities	<u>2,875,162</u>	<u>2,651,104</u>
Total current liabilities	<u>63,253,674</u>	<u>58,782,912</u>
LONG-TERM LIABILITIES:		
Due to Lottery Proceeds Fund - Deferred	3,787,882	4,291,316
Long-term grand prize winner liabilities at present value	<u>65,472,842</u>	<u>68,724,564</u>
Total long-term liabilities	<u>69,260,724</u>	<u>73,015,880</u>
Total liabilities	<u>132,514,398</u>	<u>131,798,792</u>
NET ASSETS		
Invested in capital assets	4,151,722	4,986,696
Unrestricted	(4,151,722)	(4,986,696)
Restricted	<u>9,282,493</u>	<u>16,084,466</u>
Total net assets	<u>\$ 9,282,493</u>	<u>\$ 16,084,466</u>

The accompanying notes are an integral part of these financial statements.

MISSOURI STATE LOTTERY COMMISSION

(A Component Unit of the State of Missouri)

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
OPERATING REVENUES:		
On-line ticket sales	\$ 334,515,765	\$ 289,025,023
Scratch ticket sales	434,791,673	393,981,254
Pull-tab ticket sales	<u>21,846,920</u>	<u>25,041,235</u>
Total sales	791,154,358	708,047,512
Other	<u>638,392</u>	<u>539,609</u>
Total operating revenues	<u>791,792,750</u>	<u>708,587,121</u>
OPERATING EXPENSES:		
On-line prize expense	181,060,223	156,852,210
Scratch prize expense	290,005,348	261,936,705
Pull-tab prize expense	13,761,891	15,770,545
On-line retailer commissions and incentives	19,147,892	16,652,249
Scratch retailer commissions and incentives	28,421,256	25,753,105
Pull-tab retailer commissions and incentives	1,747,618	2,048,108
Cost of tickets sold	18,341,746	16,712,029
Advertising	3,048,387	5,645,268
Wages and benefits	8,505,183	8,360,125
Other general and administrative	9,705,290	10,882,599
Depreciation and amortization	<u>1,360,623</u>	<u>1,673,881</u>
Total operating expenses	<u>575,105,457</u>	<u>522,286,824</u>
Operating income	<u>216,687,293</u>	<u>186,300,297</u>
NONOPERATING REVENUES (EXPENSES):		
Interest income	470,448	382,523
Unclaimed prizes	12,283,414	16,720,584
Net increase (decrease) in the fair value of investments held for grand prize winners	(1,546,223)	11,259,456
Amortization of grand prize winner liability	(5,255,750)	(5,473,304)
Gain (loss) on disposal of capital assets	(13,972)	62,857
Transfers to State of Missouri	<u>(229,427,183)</u>	<u>(203,466,261)</u>
Total nonoperating expense	<u>(223,489,266)</u>	<u>(180,514,145)</u>
Changes in net assets	(6,801,973)	5,786,152
TOTAL NET ASSETS AT BEGINNING OF YEAR	<u>16,084,466</u>	<u>10,298,314</u>
TOTAL NET ASSETS AT END OF YEAR	<u>\$ 9,282,493</u>	<u>\$ 16,084,466</u>

The accompanying notes are an integral part of these financial statements.

MISSOURI STATE LOTTERY COMMISSION

(A Component Unit of the State of Missouri)

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from retailers	\$ 789,581,039	\$ 695,176,443
Cash received from others	(55,514)	321,479
Cash paid for prizes	(478,616,771)	(431,315,737)
Cash paid for retailer commissions	(49,131,813)	(44,105,620)
Cash paid for employee services	(8,466,630)	(8,378,872)
Cash paid for other expenses	<u>(31,062,086)</u>	<u>(33,710,666)</u>
Net cash provided by operating activities	<u>222,248,225</u>	<u>177,987,027</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Transfers to State of Missouri	<u>(230,318,233)</u>	<u>(193,940,549)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchases of capital assets	(586,934)	(749,012)
Proceeds from sale of capital assets	<u>47,313</u>	<u>64,092</u>
Net cash used for capital and related financing activities	<u>(539,621)</u>	<u>(684,920)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturity of investments	10,434,000	10,198,000
Interest received	<u>470,448</u>	<u>382,523</u>
Net cash provided by investing activities	<u>10,904,448</u>	<u>10,580,523</u>
Net increase (decrease) in cash and cash equivalents	2,294,819	(6,057,919)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>10,748,318</u>	<u>16,806,237</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 13,043,137</u>	<u>\$ 10,748,318</u>

MISSOURI STATE LOTTERY COMMISSION

(A Component Unit of the State of Missouri)

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED		
BY OPERATING ACTIVITIES:		
Operating income	\$ 216,687,293	\$ 186,300,297
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,360,623	1,673,881
Unclaimed prizes	12,283,414	16,720,584
Payments to grand prize winners	(10,434,000)	(10,198,000)
Changes in operating assets and liabilities:		
Accounts receivable	(1,635,374)	(13,076,199)
Other receivable	(631,851)	(13,000)
Prepaid expense	(90,258)	109,103
Accounts payable and other accrued liabilities	347,101	(250,778)
Accrued prize liabilities	4,361,277	(3,278,861)
Net cash provided by operating activities	<u>\$ 222,248,225</u>	<u>\$ 177,987,027</u>
NON-CASH ACTIVITIES:		
Unrealized gains (losses) on investments held for grand prize winners	\$ (1,546,223)	\$ 11,259,456
Amortization of long-term annuity prize liability	\$ 5,255,750	\$ 5,473,304

The accompanying notes are an integral part of these financial statements.

MISSOURI STATE LOTTERY COMMISSION
(A Component Unit of the State of Missouri)

NOTES TO BASIC FINANCIAL STATEMENTS

JUNE 30, 2004 AND 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Missouri State Lottery Commission (the Lottery) was created by the passage of a constitutional amendment on November 6, 1984 by the citizens of the State of Missouri. The Lottery is a Type III division assigned to the Missouri Department of Revenue as defined in Section 313.210 of the Missouri Revised Statutes. The Department of Revenue has no control, supervision, or authority over the actions or decisions of the Lottery. The Commission consists of five members appointed by the Governor with the advice and consent of the Senate. The day-to-day operations are administered by the executive director and administrative staff as designated by the Commission. In accordance with Governmental Accounting Standards Board Statement No. 14, the Lottery, although a legally separate entity, is considered to be a component unit of the State of Missouri. This component unit provides services which exclusively, or almost exclusively, benefit the State of Missouri.

Basis of Presentation

The Lottery is accounted for as a proprietary-type enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or where the periodic determination of net income is appropriate. In reporting its financial activities, the Lottery applies all applicable private sector standards of accounting and financial reporting issued prior to December 1, 1989, to the extent that these standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board (GASB).

Basis of Accounting

The financial statements of the Lottery have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of accounting refers to when revenues, expenses and the related assets and liabilities are recognized in the accounts and reported in the financial statements. Measurement focus refers to what is being measured. The financial statements are prepared on the accrual basis of accounting and on an economic resources measurement focus in accordance with GAAP.

The Lottery distinguishes operating revenue and expenses from nonoperating items. The principal operating revenue of the Lottery is primarily comprised of sales from scratch, pull-tab and on-line tickets. Operating expenses mainly consist of payments to prize winners, commissions to retailer agents and payments to vendors and employees.

Revenue Recognition

Sales of on-line lottery tickets are generated by the semiweekly "LOTTO" and "Powerball" games, and the daily "Club Keno", "Show-Me 5 Paydown", "PICK 4", "PICK 3", and Xtra games. Sales of on-line lottery tickets are made through licensed retail sales outlets via on-line terminals maintained by the retailers. Ticket sales are recognized at the time the player purchases a ticket from the retailer.

Sales of scratch lottery tickets are made to licensed retail sales outlets with the right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player. Allowances of approximately \$957,000 and \$1,064,000 at June 30, 2004 and 2003, respectively, have been established for estimated tickets to be returned by retailers.

Sales of pull-tab lottery tickets are made to licensed retail sales outlets with no right of return. Ticket sales are recognized upon the sale of tickets to retailers and are valued at the sale price to the player.

Prizes

Expenses for on-line lottery ticket prizes are recorded based on a minimum of 45% of on-line lottery ticket sales. This amount is recognized and accrued as prize liability. Actual prizes paid are treated as a reduction of the prize liability.

Grand prize winners have the choice of receiving the prize in 25 annual installments or a portion of the prize in one lump-sum payment.

Expenses for scratch lottery ticket and pull-tab lottery ticket prizes are recorded based upon the unique, predetermined prize structure for each game and are accrued as tickets are sold to the retailer.

Unclaimed Prizes

State statutes require that unclaimed prize monies be retained by the Lottery for the person entitled thereto for 180 days after the time the prize was awarded. If no claim is made for the prize within such time, the prize money reverts to the Lottery. Effective July 1, 2000, at the directive of the State of Missouri, the Lottery transfers to the Lottery Proceeds Fund all prizes that remain unclaimed for more than 180 days. During the years ended June 30, 2004 and 2003, unclaimed prizes in the amount of approximately \$12,300,000 and \$16,700,000, respectively, were transferred to the Lottery Proceeds Fund. For the years ended June 30, 2004 and 2003, this amount has been included as nonoperating revenue on the statement of revenues, expenses and changes in fund net assets with a corresponding amount included as a transfer to State of Missouri.

Cash and Cash Equivalents

For purposes of the cash flows statement, cash and cash equivalents consist of cash in banks, repurchase agreements and cash and money market funds on deposit with the State Treasurer. The Lottery considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Investments Held for Grand Prize Winners

Since March 1990, to fund future payments under grand prize winner prize claims, the Lottery purchases U.S. Treasury zero coupon bonds, with maturities approximating deferred grand prize annuity installment amounts and due dates. The securities purchased are held in the Lottery's name in safekeeping by the Federal Reserve Bank in a separate account. The investments in these securities are carried at fair value.

Retailer Fees

Licensed retailers are charged a fee for the right to sell lottery tickets. Additionally, certain retailers pay an annual fee in lieu of obtaining an insurance bond. Such fees are maintained in a reserve fund to offset uncollectable accounts receivable from retailers. This reserve fund approximated \$151,000 and \$169,000 at June 30, 2004 and 2003, respectively, and is reflected as a reduction of accounts receivable on the accompanying statements of net assets.

Capital Assets

Property and equipment greater than \$1,000 are carried at cost, less accumulated depreciation. Property and equipment received as settlement for liquidated damages are recorded at fair value on the date received. Depreciation is computed on the straight-line method over the estimated lives of the related assets, which range from three to fifteen years for autos and equipment and nineteen years for buildings. When assets are retired or otherwise disposed, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in nonoperating revenues and expenses for the period.

Net Assets

Restricted net assets represent the unrealized gains or losses on investments held for grand prize winners. GASB Statement No. 31 requires that certain investments be reported at fair value with gains and losses reflected in the statement of operations. The Lottery uses investments only to fund its annuity prize obligations and intends to hold the investments to maturity. Market gains or losses represent temporary fluctuations and are not recognized in the calculation of the amounts due to the Lottery Proceeds Fund.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Due to Lottery Proceeds Fund

All income before transfers of the Lottery, except for net increase in the fair value of investments held for grand prize winners and amortization of grand prize winner liabilities, as described in the accompanying statements of revenues, expenses and changes in fund net assets, accrues to the benefit of the State of Missouri. Transfers are made to the Lottery Proceeds Fund, which shall be appropriated by the State solely for the institutions of elementary, secondary and higher education.

Transfers are made monthly and are based on estimated net income before transfers. A portion of the liability to the Lottery Proceeds Fund, equal to the net book value of capital additions after September 1, 1988, and all amounts receivable from the Multi-State Lottery Association, are deferred and are not subject to current transfers.

Compensated Absences

Under the terms of the Lottery's personnel policy, employees are granted vacation and sick leave in varying amounts, based upon length of service. In the event of termination or separation, an employee is generally paid for accumulated vacation up to 240 hours if in service for less than ten years; 288 hours for service between ten and fifteen years; and 336 hours if service exceeds fifteen years. Accordingly, it is the Lottery's policy to record vacation pay as an expense as it is earned. The amount of earned but unused accumulated vacation is included as an accrued liability in the accompanying financial statements.

Retiring employees receive an additional month of credited service for every twenty-one days of accumulated sick leave on the date of termination. Credited service is used to calculate retirement benefits administered by the Missouri State Employees Retirement System. The amount of earned but unused sick leave has no material financial effect on the Lottery.

Risk Management

The Lottery's risk management activities for workers' compensation and unemployment are recorded in the Workers' Compensation Fund and the Employment Security Fund, funds of the State of Missouri. The Lottery reimburses these funds for actual disbursements made on the Lottery's account.

Employees are offered various health insurance coverage programs administered by the Missouri Consolidated Health Care Plan (MCHCP). The Lottery contributes a fixed monthly payment for each covered employee to MCHCP as appropriated by the General Assembly of the State of Missouri.

The Lottery's major assets including data processing equipment, buildings, and business interruption are insured by a third party carrier maintained by the Office of Risk Management.

There were no significant reductions in insurance coverage from the prior year. Insurance settlements did not exceed insurance coverage in the past three years.

Budgetary Authority

The Lottery annually submits a request for appropriation through the budgetary process of the State of Missouri. All expenses of the Lottery are subject to the State of Missouri appropriation process.

Reclassification

Certain prior year information was reclassified to conform to the current year presentation.

2. STATUTORY REQUIREMENTS:

Missouri statutes provide that a minimum of 45% of the money received from the sale of lottery tickets shall be allocated to prizes. The costs of operating the Lottery, including all commissions to retailers, promotional costs, and all other administrative expenditures, are appropriated by the General Assembly of the State of Missouri.

The Lottery receives certain services for no charge from other Missouri state government agencies. Investigative services are provided by the Missouri State Highway Patrol. The Office of Administration provides certain services to process expenditures and payroll for the Lottery.

3. CASH AND CASH EQUIVALENTS:

Cash, other than petty cash and the imprest fund, is part of the common cash pool in the State Treasury. The State of Missouri invests such cash in excess of what is necessary to meet current obligations. The fair value in the common cash pool is the same as the value of the pool shares. At June 30, 2004 and 2003, the Lottery's share in the State's common cash pool was \$208,989 and \$8,972,633, respectively. The book balance of the imprest fund was \$12,832,048, and the bank balance was \$13,322,012 as of June 30, 2004.

Collateral is required by state statutes for demand deposits and certificates of deposit. The fair value of collateral must equal 100% of deposits not covered by federal deposit insurance. Obligations that may be pledged as collateral are governed by state statute and include U.S. government and U. S. agency bonds and securities, general obligation bonds of any of the fifty states, general obligation bonds of any Missouri county and certain cities and special districts, and revenue bonds of certain Missouri agencies. Written custodial agreements are required which provide, among other things, that the collateral be held separate from the assets of the custodial bank.

4. INVESTMENTS HELD FOR GRAND PRIZE WINNERS:

As provided for by Article III, Section 39(b) of the Missouri Constitution, the Lottery purchases United States Treasury Zero Coupon Bonds for the specific purpose of funding future grand prize winner prize claims. These investments are carried at fair value in the amounts of \$85,339,335 and \$95,243,030 at June 30, 2004 and 2003, respectively. The maturity value of securities held at June 30, 2004 and 2003, was \$109,339,000 and \$116,173,000, respectively.

At June 30, 2004, the Lottery had the following investments:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (In Years)</u>			
		<u>Less Than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More Than 10</u>
<u>Investments in prize annuities:</u>					
United States Treasury					
Zero Coupon Bonds	\$85,339,335	\$10,515,074	\$46,599,625	\$21,039,807	\$7,184,829

Investments in prize annuities are subject to changes in fair value due to interest rate risk. However, to satisfy the annual installment obligations to prize winners, these bonds are held to maturity. The fair value at maturity is the face value of the bonds, regardless of the changes in value during the time that the investments are outstanding.

5. ON-LINE TICKET SALES:

On-line ticket sales consist of the following:

	<u>2004</u>	<u>2003</u>
Powerball	\$ 147,232,847	\$ 125,324,451
PICK 3	53,946,082	53,569,248
LOTTO	35,015,934	28,736,839
Show-Me 5 Paydown	24,337,775	22,665,639
PICK 4	18,436,614	16,157,968
Club Keno	51,531,568	42,570,878
Xtra	<u>4,014,945</u>	<u>0</u>
	<u>\$ 334,515,765</u>	<u>\$ 289,025,023</u>

6. CAPITAL ASSETS:

The changes in capital assets consist of the following:

	<u>June 30, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2004</u>
Capital assets not being depreciated:				
Land	\$ 352,973	\$ 0	\$ 0	\$ 352,973
Capital assets being depreciated:				
Buildings	4,291,899	0	0	4,291,899
Computers	3,861,458	311,327	124,649	4,048,139
Equipment	10,878,620	115,164	165,314	10,828,470
Automobiles	1,585,122	160,443	278,335	1,467,230
Other	45,000	0	0	45,000
Total capital assets being depreciated	<u>20,662,099</u>	<u>586,934</u>	<u>568,298</u>	<u>20,680,735</u>
Less accumulated depreciation for:				
Buildings	2,319,723	227,097	0	2,546,820
Computers	2,649,154	401,830	115,622	2,935,362
Equipment	9,932,968	440,904	113,056	10,260,819
Automobiles	1,114,712	289,285	278,335	1,125,662
Other	11,819	1,504	0	13,323
Total accumulated depreciation	<u>16,028,376</u>	<u>\$ 1,360,623</u>	<u>\$ 507,013</u>	<u>16,881,986</u>
Total capital assets being depreciated, net	<u>4,633,723</u>			<u>3,798,749</u>
Capital assets, net	<u>\$ 4,986,696</u>			<u>\$ 4,151,722</u>

	<u>June 30, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2003</u>
Capital assets not being depreciated:				
Land	\$ 352,973	\$ 0	\$ 0	\$ 352,973
Capital assets being depreciated:				
Buildings	4,291,899	0	0	4,291,899
Computers	3,513,508	353,223	5,273	3,861,458
Equipment	10,792,701	92,789	6,870	10,878,620
Automobiles	1,553,335	303,000	271,213	1,585,122
Other	45,000	0	0	45,000
Total capital assets being depreciated	<u>20,196,443</u>	<u>749,012</u>	<u>283,356</u>	<u>20,662,099</u>
Less accumulated depreciation for:				
Buildings	2,093,247	226,476	0	2,319,723
Computers	2,287,067	366,126	4,039	2,649,154
Equipment	9,166,255	773,583	6,870	9,932,968
Automobiles	1,079,728	306,196	271,212	1,114,712
Other	10,319	1,500	0	11,819
Total accumulated depreciation	<u>14,636,616</u>	<u>\$ 1,673,881</u>	<u>\$ 282,121</u>	<u>16,028,376</u>
Total capital assets being depreciated, net	<u>5,559,827</u>		<u>4,633,723</u>	
Capital assets, net	<u>\$ 5,912,800</u>			<u>\$ 4,986,696</u>

7. PENSION PLAN:

The Lottery participates in the Missouri State Employees' Retirement System (MOSERS) plan, a cost-sharing multiple employer defined benefit retirement plan covering all the employees of the State of Missouri. The plan is administered by the MOSERS Board of Trustees in accordance with Sections 104.010 and 104.312 to 104.800 of the Revised Statutes of Missouri. Substantially all full-time employees of the Lottery are covered by the plan. MOSERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to: Missouri State Employees' Retirement System, 907 Wildwood Drive, P.O. Box 209, Jefferson City, Missouri 65102, or by calling (800) 827-1067.

The Plan provides retirement, death and disability benefits to its members. Benefits for state employees are fully vested after five years of credited service. Employees may retire on or after age 55 and receive reduced benefits (full benefits if they are at least age 50 and their combined age and service equal 80). The Plan cannot be terminated. The Lottery's full time employees do not contribute to the Plan. The State of Missouri is required to make all contributions at an actuarially determined rate. The

current rate of contribution for retirement and long-term disability is 8.81% and 0.57% of total payroll, respectively.

For fiscal years ended June 30, 2004, 2003, and 2002, the annual pension cost was approximately \$639,000, \$602,000, and \$778,000, respectively, and was equal to 100% of the annual pension cost required to be contributed for those years.

8. LEASES:

Operating Leases

The Lottery's regional facilities are held under operating lease agreements through June 30, 2004, with renewal options available for one to three additional one-year periods. Annual rent expense for these facilities totaled approximately \$316,000 in fiscal 2004 and 2003.

The Lottery leases ticket vending machines under operating lease agreements through June 30, 2004, with options available for additional one-year periods. Annual lease expense for these machines totaled approximately \$576,000 and \$693,000 in fiscal 2004 and 2003, respectively.

9. CONTRACTUAL ARRANGEMENTS:

The Lottery maintains contractual arrangements with providers of goods and services critical to the Lottery's operations. Significant contracts include an agreement with the provider of the Lottery's on-line game computer systems and agreements with producers of the Lottery's scratch and pull-tab games tickets, among others. The contracts generally run for one year, with one-year renewals available at the option of the Lottery. The contracts require the Lottery to compensate vendors for goods and services that meet stated quality standards.

The Lottery is a member of the Multi-State Lottery Association (MUSL) which consists of 28 state and district lotteries (member lotteries) and operates the on-line Powerball game. Under separate agreements between MUSL and each lottery, the member lotteries sell tickets for the Powerball game and remit 50% of sales to prize winners or to MUSL for payment of prizes. Member lotteries also fund MUSL's operating expenses based on allocations by MUSL.

Powerball grand prize winners have the choice of receiving the prize in 30 annual installments or a portion of the prize in one lump-sum payment. Investment securities, with maturities that approximate all grand prize winner payments due to winners of MUSL games, are maintained by MUSL. The investments and related prize liabilities for winners of these games from the state of Missouri are excluded from the accompanying financial statements. Future grand prize winner payments of MUSL games due to winners in Missouri are approximately \$96,289,000 as of June 30, 2004.

The Lottery has contributed to a prize reserve fund and set prize reserve fund, separately maintained by MUSL, to protect MUSL members in case of unforeseen liabilities and to pay certain prizes associated with Powerball, respectively. With certain restrictions, these fund balances are refundable to member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 2004, the Lottery's portion of the prize reserve fund and set prize reserve fund was approximately \$5,013,000 and \$1,671,000, respectively. The Lottery has charged amounts placed into the prize reserve funds to prize expense as the related sales have occurred.

The Lottery has contributed to an account with MUSL which is used to pay certain operating expenses incurred by member lotteries for the Powerball game. With certain restrictions, the balances in this account are refundable to the member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 2004, the Lottery's portion of the balance of this account was approximately \$221,000 and is included in interest income.

10. AMOUNTS HELD ON BEHALF OF GRAND PRIZE WINNERS LIABILITY:

The Lottery has an implied contract to make future installment payments to grand prize winners, and as such, recognizes this as amounts held on behalf of grand prize winners. Amounts due to grand prize winners are carried at the estimated present value of the prizes that will eventually be awarded. The present value of these payments at June 30, 2004 and 2003 was \$76,056,842 and \$79,158,564, respectively. This is funded with the maturing U.S. Treasury zero coupon bonds that are restricted for this purpose. The balances of these maturities at June 30, 2004, are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2005	\$ 10,584,000
2006	10,544,000
2007	10,534,000
2008	10,534,000
2009	10,534,000
2010 through 2014	36,911,000
2015 through 2019	11,556,000
2020 through 2024	6,282,000
2025 through 2028	<u>1,860,000</u>
Total installment payments due	109,339,000
Less- Interest portion	<u>33,282,158</u>
	<u>\$ 76,056,842</u>

Prior to March 1990, the Lottery purchased annuity contracts in the name of the prize winners from selected insurance companies to fund the "LOTTO" grand prize claims. Because it is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner, neither the value of the annuities nor the value of the related future payments are reflected in the accompanying financial statements. The Lottery would assume liability for future payments if the insurance companies were to default on their payments. Future installment payments to be made to grand prize winners by these insurance companies totaled approximately \$18,761,000 at June 30, 2004.

11. LONG-TERM LIABILITIES:

The changes in long-term liabilities consist of the following:

	<u>June 30, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2004</u>	<u>Current Portion</u>
Due to Lottery Proceeds Fund	\$ 22,893,384	\$229,427,183	\$230,318,233	\$ 22,002,334	\$ 18,214,452
Grand prize winner liabilities	<u>79,158,564</u>	<u>7,332,278</u>	<u>10,434,000</u>	<u>76,056,842</u>	<u>10,584,000</u>
Total	<u>\$ 102,051,948</u>	<u>\$236,759,461</u>	<u>\$240,752,233</u>	<u>\$ 98,059,176</u>	<u>\$ 28,798,452</u>

	<u>June 30, 2002</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2003</u>	<u>Current Portion</u>
Due to Lottery Proceeds Fund	\$ 13,367,672	\$203,466,262	\$193,940,550	\$ 22,893,384	\$ 18,602,068
Grand prize winner liabilities	<u>80,524,092</u>	<u>8,832,472</u>	<u>10,198,000</u>	<u>79,158,564</u>	<u>10,434,000</u>
Total	<u>\$ 93,891,764</u>	<u>\$212,298,734</u>	<u>\$204,138,550</u>	<u>\$ 102,051,948</u>	<u>\$ 29,036,068</u>

12. CONTINGENCIES:

There are claims and/or lawsuits to which the Lottery is a party as a result of matters arising in the ordinary course of business. The final outcome of any claim or lawsuit is not presently determinable. Management does not anticipate the resolution of these matters to have a material adverse effect on the financial condition of the Lottery.

**STATISTICAL SECTION
(UNAUDITED)**



Missouri Lottery Statistics

Information for the Missouri Lottery for the last ten fiscal years, 1995 through 2004, is presented in the accompanying schedules and charts. The Missouri Lottery was created on November 6, 1984 by the passage of a constitutional amendment and began selling tickets in January 1986.

The following information is presented in the accompanying schedules and charts:

Revenue – includes sales, interest income, retailer fees and other income amounts. Interest income does not reflect interest from investments for Lotto payments.

Sales – reflects the face value of lottery tickets. Pick 5 game sales include SuperCash sales from July 1994 through November 1994 and ShowMe 5 sales from November 1994 through June 2004.

Retailer commission and incentives – includes the base commission and cashing, promotional and program incentive payments.

Prizes – reflects the liability incurred for payments to winners.

Ticket costs – includes the purchase cost of instant and pull-tab tickets and payments to the on-line games service provider.

Administration – includes all operating expenses not included in prizes, retailer commissions and incentives or ticket costs.

Transfers to the State – reflects the transfer of net income, excluding unrealized gains on investments and amortization of grand prize winner liability, to the Lottery Proceeds Fund for fiscal years 1995 through 2004. Transfers made during fiscal year 2004 include \$12,283,414 of unclaimed prizes. The Lottery Proceeds Fund is appropriated by the Missouri State General Assembly to the Department of Higher Education and the Department of Elementary and Secondary Education. Profits not yet transferred are shown on the balance sheet as a liability.

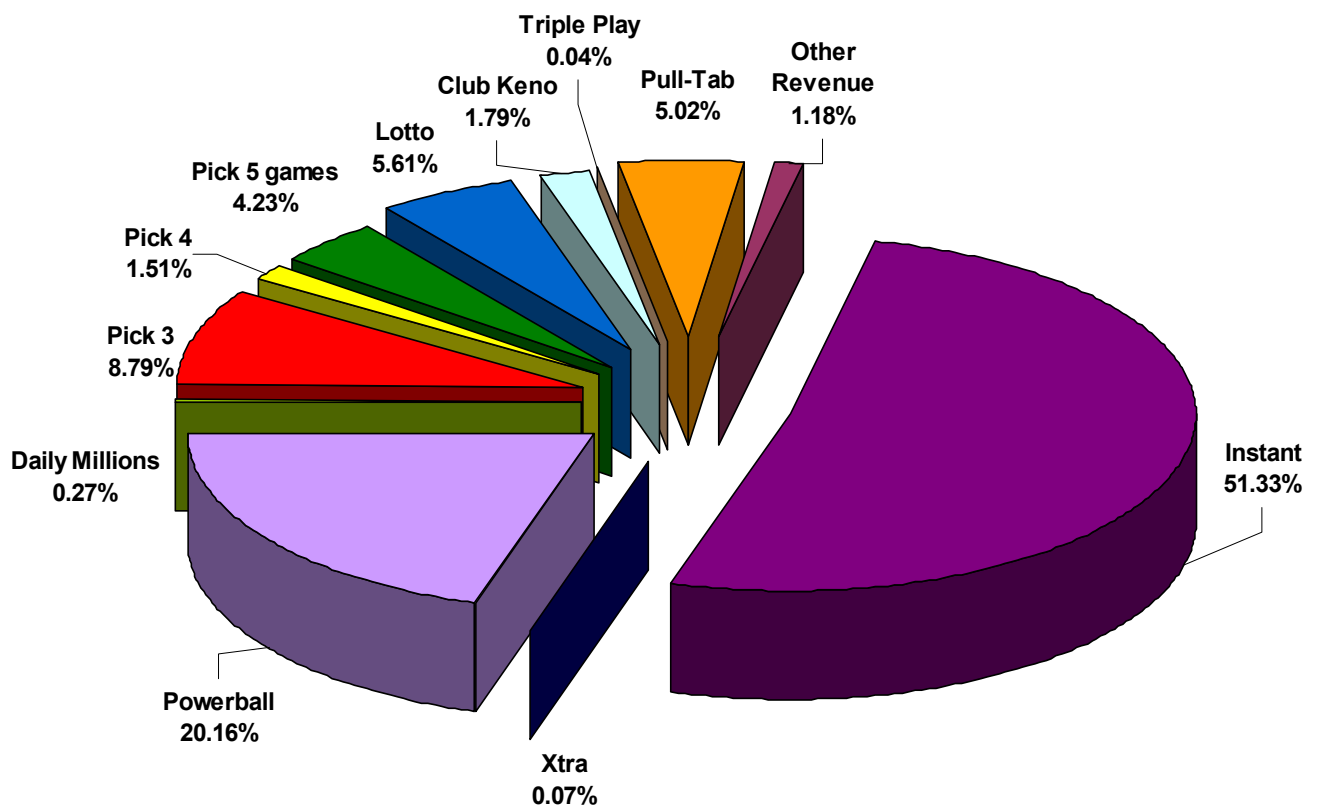
Expenses and transfers – includes prizes, retailer commissions and incentives, ticket costs and administration costs as described above, as well as transfers made to the state.

Unless otherwise noted, the source for the data used to prepare the following schedules and charts is the Division of Finance and Administration of the Missouri Lottery.

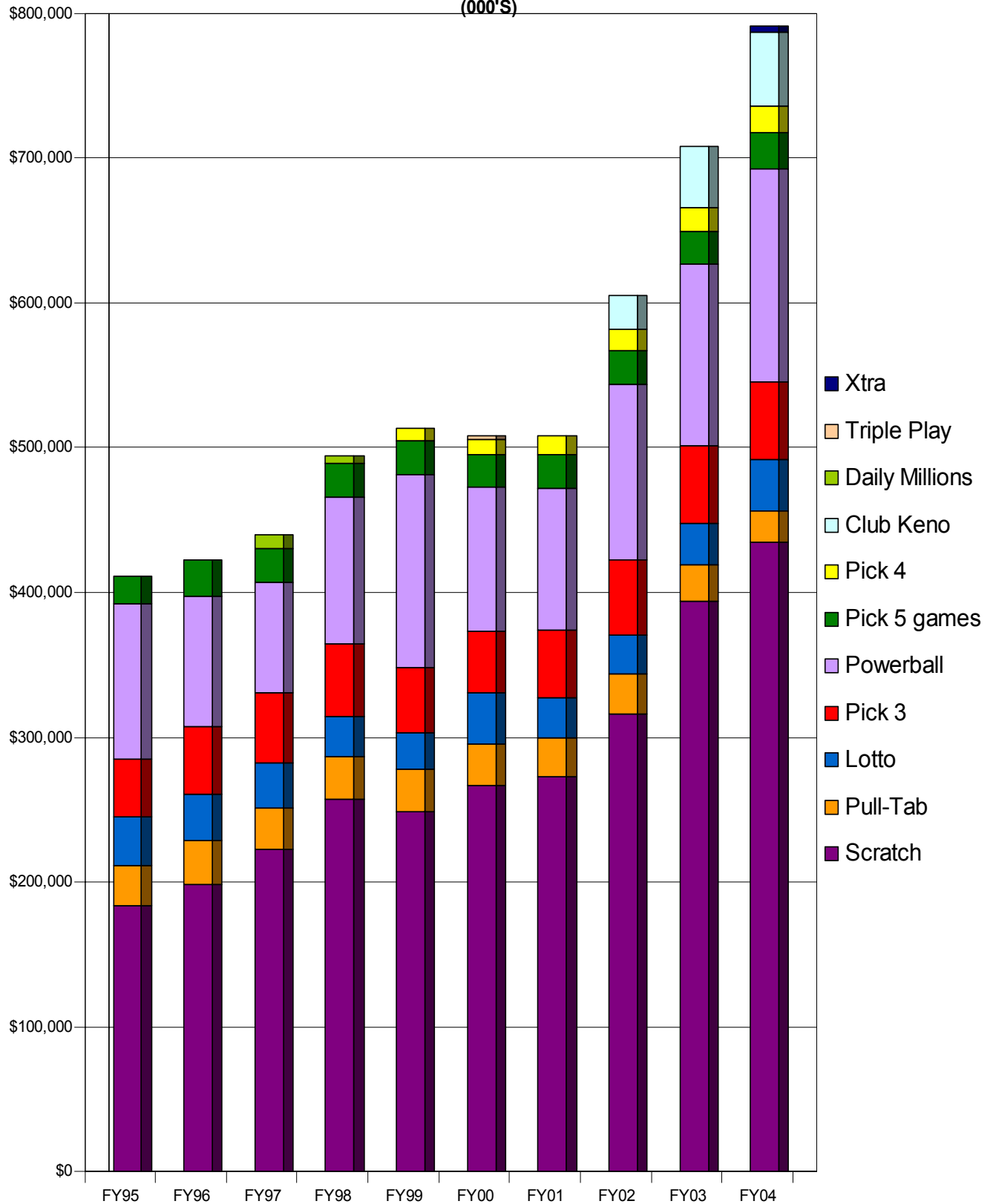
**MISSOURI LOTTERY
REVENUES
FISCAL YEARS 1995 THROUGH 2004
(000'S)**

	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04
Sales										
Instant Tickets	<u>\$ 183,790</u>	<u>\$ 198,735</u>	<u>\$ 222,343</u>	<u>\$ 257,643</u>	<u>\$ 248,511</u>	<u>\$ 266,708</u>	<u>\$ 272,658</u>	<u>\$ 316,397</u>	<u>\$ 393,981</u>	<u>\$ 434,791</u>
Pull-Tab Tickets	<u>27,639</u>	<u>29,591</u>	<u>28,492</u>	<u>29,139</u>	<u>29,241</u>	<u>28,700</u>	<u>26,579</u>	<u>27,369</u>	<u>25,041</u>	<u>21,847</u>
On-Line:										
Lotto	33,520	32,684	31,892	27,875	24,982	35,292	28,459	27,031	28,737	35,016
Pick 3	40,051	46,610	48,362	49,712	45,623	42,368	46,539	51,786	53,569	53,946
Powerball	106,848	89,377	76,146	101,083	132,599	99,966	97,920	121,475	125,324	147,233
Pick 5 games	19,817	25,534	22,784	23,667	23,537	21,924	23,281	22,715	22,666	24,338
Pick 4	-	-	-	-	8,759	10,550	12,865	15,292	16,158	18,437
Club Keno	-	-	-	-	-	-	-	3,124	42,571	51,531
Daily Millions	-	-	9,574	5,180	-	-	-	-	-	-
Xtra	-	-	-	-	-	-	-	-	-	4,015
Triple Play	-	-	-	-	-	2,337	-	-	-	-
Total On-Line	<u>200,236</u>	<u>194,205</u>	<u>188,758</u>	<u>207,517</u>	<u>235,500</u>	<u>212,437</u>	<u>209,064</u>	<u>241,423</u>	<u>289,025</u>	<u>334,516</u>
Total Sales	<u>411,665</u>	<u>422,531</u>	<u>439,593</u>	<u>494,299</u>	<u>513,252</u>	<u>507,845</u>	<u>508,301</u>	<u>585,189</u>	<u>708,047</u>	<u>791,154</u>
Other Revenues										
Interest	937	1,124	1,045	946	1,518	1,564	1,541	757	383	470
Other	<u>155</u>	<u>292</u>	<u>292</u>	<u>185</u>	<u>1,598</u>	<u>204</u>	<u>13,756</u>	<u>7,391</u>	<u>17,323</u>	<u>12,922</u>
Total Other	<u>1,092</u>	<u>1,416</u>	<u>1,337</u>	<u>1,131</u>	<u>3,116</u>	<u>1,768</u>	<u>15,297</u>	<u>8,148</u>	<u>17,706</u>	<u>13,392</u>
Total Revenues	<u>\$ 412,757</u>	<u>\$ 423,947</u>	<u>\$ 440,930</u>	<u>\$ 495,430</u>	<u>\$ 516,368</u>	<u>\$ 509,613</u>	<u>\$ 523,598</u>	<u>\$ 593,337</u>	<u>\$ 725,753</u>	<u>\$ 804,546</u>

**MISSOURI LOTTERY
REVENUE DISTRIBUTION
JULY 1994 THROUGH JUNE 2004**

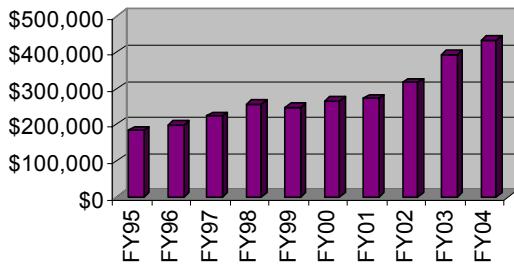


**MISSOURI LOTTERY
SALES BY PRODUCT
FISCAL YEARS 1995 THROUGH 2004
(000'S)**

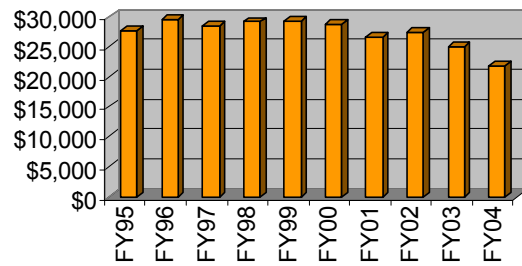


**MISSOURI LOTTERY
SALES BY FISCAL YEAR BY PRODUCT LINE
FISCAL YEARS 1995 THROUGH 2004
(0000'S)**

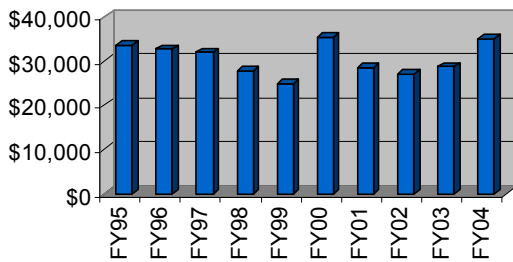
Scratchers



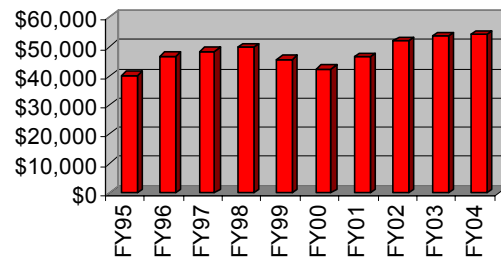
Pull-Tabs



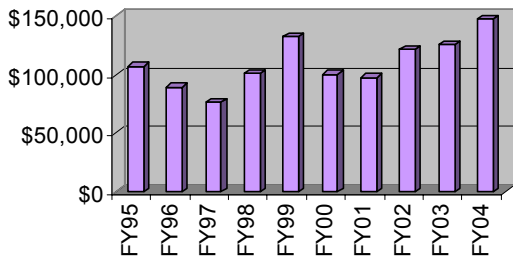
Lotto



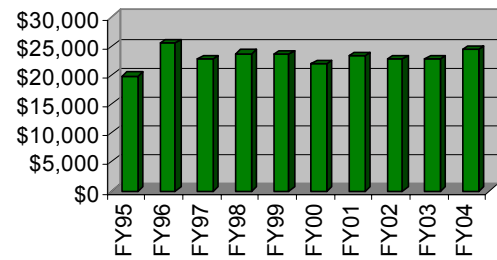
Pick 3



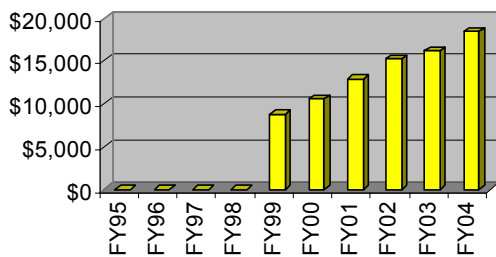
Powerball



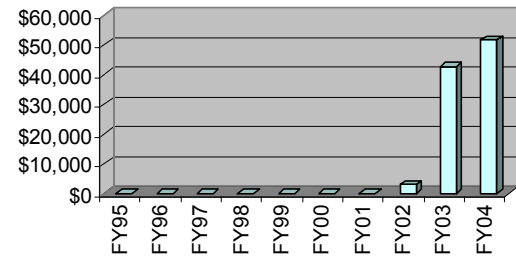
Pick 5 Games



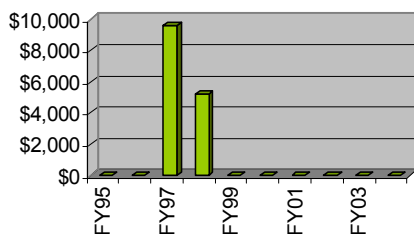
Pick 4



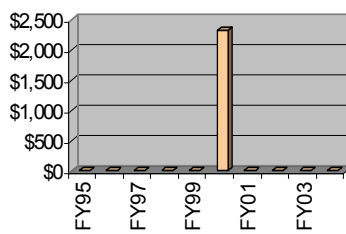
Club Keno



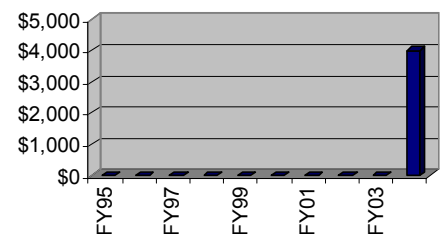
Daily Millions



Triple Play



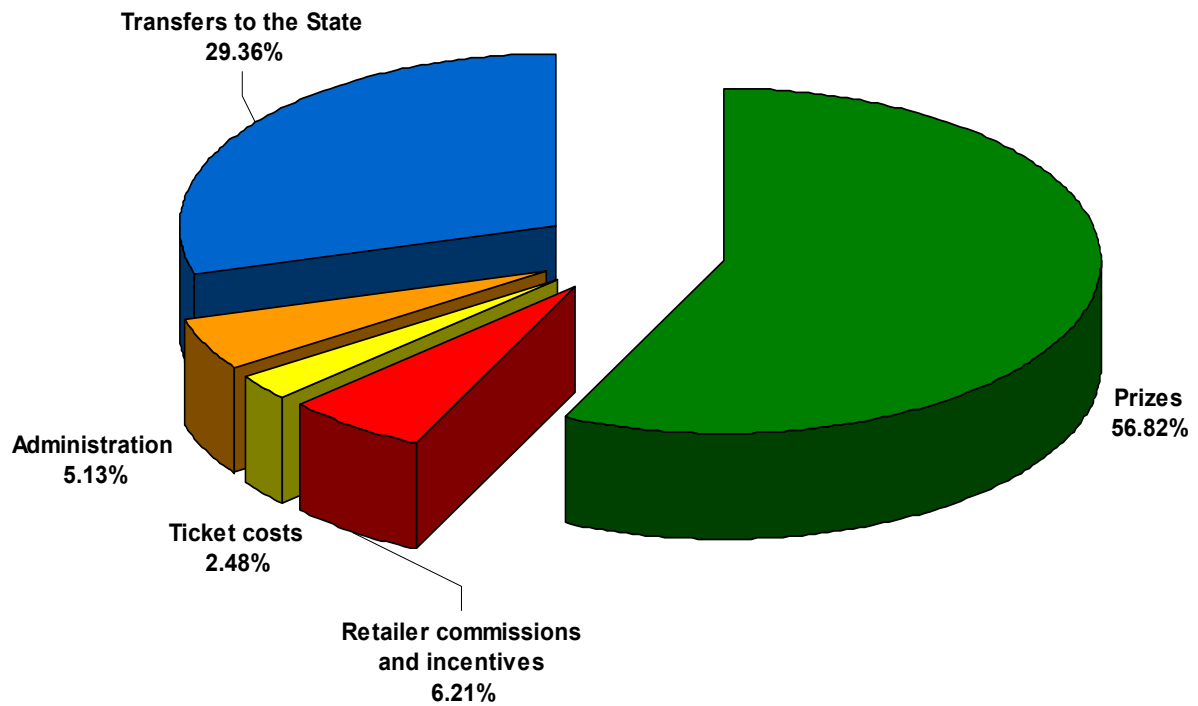
Xtra



MISSOURI LOTTERY
EXPENSES AND TRANSFERS TO THE STATE
FISCAL YEARS 1995 THROUGH 2004
(000'S)

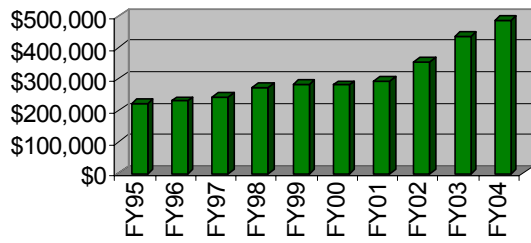
	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04
Expenses										
Prizes	\$221,751	\$229,521	\$241,863	\$273,168	\$282,307	\$280,506	\$293,219	\$353,075	\$434,559	\$484,827
Retailer commissions										
and incentives	24,670	26,451	27,751	31,111	32,278	32,389	32,430	37,101	44,454	49,317
Ticket costs	12,339	12,557	10,805	12,458	13,196	12,580	12,531	13,289	16,712	18,342
Administration	<u>24,575</u>	<u>27,360</u>	<u>27,847</u>	<u>29,168</u>	<u>30,024</u>	<u>30,120</u>	<u>31,504</u>	<u>29,833</u>	<u>26,562</u>	<u>22,619</u>
Total Expenses	<u>283,335</u>	<u>295,889</u>	<u>308,266</u>	<u>345,905</u>	<u>357,805</u>	<u>355,595</u>	<u>369,684</u>	<u>433,298</u>	<u>522,287</u>	<u>575,105</u>
Transfers to the State	<u>129,422</u>	<u>128,058</u>	<u>132,664</u>	<u>149,525</u>	<u>158,563</u>	<u>154,018</u>	<u>153,915</u>	<u>160,039</u>	<u>203,466</u>	<u>229,427</u>
Total Expenses and Transfers	<u>\$412,757</u>	<u>\$423,947</u>	<u>\$440,930</u>	<u>\$495,430</u>	<u>\$516,368</u>	<u>\$509,613</u>	<u>\$523,599</u>	<u>\$593,337</u>	<u>\$725,753</u>	<u>\$804,532</u>

**MISSOURI LOTTERY
EXPENSES AND TRANSFERS DISTRIBUTION
JULY 1994 THROUGH JUNE 2004**

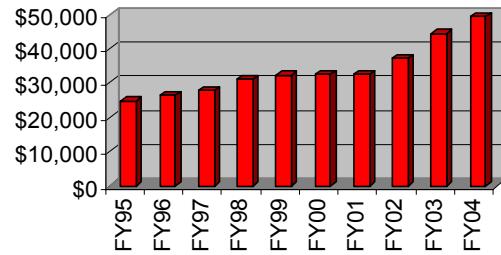


MISSOURI LOTTERY EXPENSES AND TRANSFERS FISCAL YEARS 1995 THROUGH 2004 (000'S)

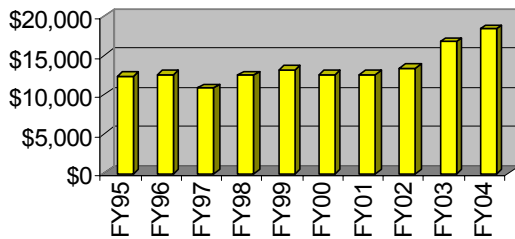
Prizes



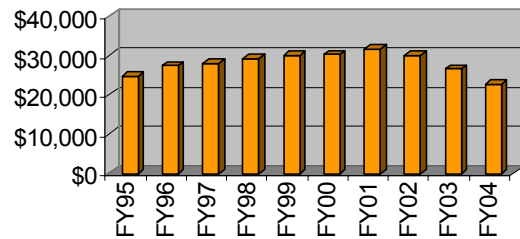
Retailer Commissions and Incentives



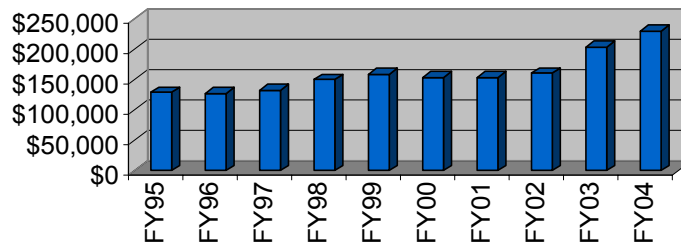
Ticket Costs



Administration



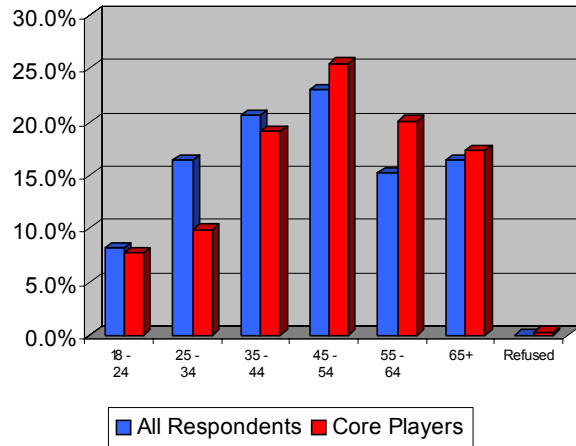
Transfers to the State



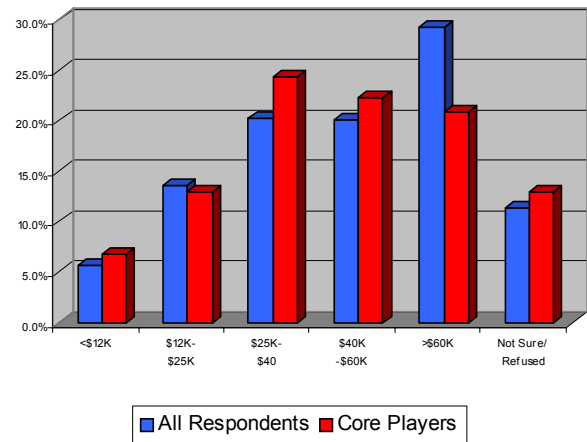
MISSOURI LOTTERY DEMOGRAPHIC GROUP PARTICIPATION

Source: Missouri Lottery Track and Trend Report for FY2004

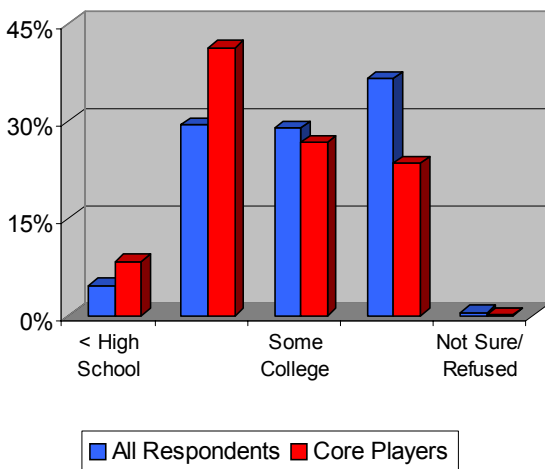
Age



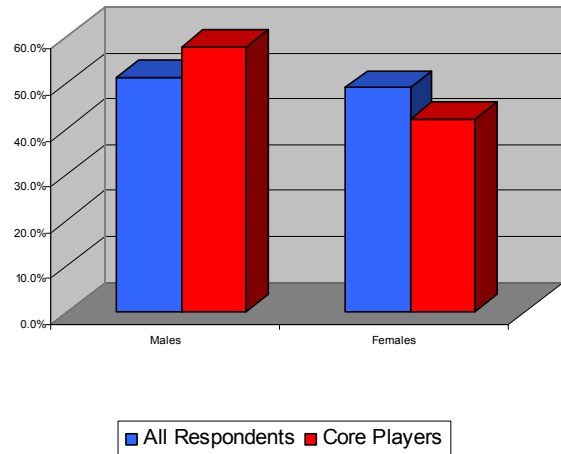
Annual Income



Education



Gender



United States Lotteries Per Capita Sales Fiscal Year 2003

Lottery Jurisdiction	FY03 Sales (millions)	Population (millions) ³	FY03 Annual Per Capita
Arizona	\$322.28	5.58	\$57.76
California	\$2,781.57	35.48	\$78.40
Colorado	\$391.53	4.55	\$86.05
Connecticut	\$865.29	3.48	\$248.65
Delaware (1)	\$628.06	0.82	\$765.93
District of Columbia ***	\$237.63	0.56	\$424.34
Florida	\$2,867.98	17.02	\$168.51
Georgia	\$2,604.41	8.68	\$300.05
Idaho	\$97.97	1.37	\$71.51
Illinois	\$1,585.62	12.65	\$125.35
Indiana	\$664.42	6.20	\$107.16
Iowa	\$187.83	2.94	\$63.89
Kansas	\$210.83	2.72	\$77.51
Kentucky	\$673.49	4.12	\$163.47
Louisiana	\$311.46	4.50	\$69.21
Maine	\$164.60	1.31	\$125.65
Maryland	\$1,322.60	5.51	\$240.04
Massachusetts	\$4,197.75	6.43	\$652.84
Michigan ***	\$1,783.38	10.08	\$176.92
Minnesota	\$351.82	5.06	\$69.53
Missouri	\$708.57	5.70	\$124.31
Montana	\$34.68	0.92	\$37.70
Nebraska	\$80.92	1.74	\$46.51
New Hampshire	\$221.23	1.29	\$171.50
New Jersey	\$2,074.07	8.64	\$240.05
New Mexico	\$137.33	1.87	\$73.44
New York *	\$5,395.96	19.19	\$281.19
Ohio	\$2,078.20	11.44	\$181.66
Oregon (1)	\$853.16	3.56	\$239.65
Pennsylvania	\$2,132.98	12.37	\$172.43
Rhode Island (2)	\$1,290.50	1.08	\$1,194.91
South Carolina	\$724.31	4.15	\$174.53
South Dakota (2)	\$646.95	0.76	\$851.25
Texas **	\$3,130.69	22.12	\$141.53
Vermont	\$79.50	0.62	\$128.23
Virginia	\$1,135.72	7.39	\$153.68
Washington	\$460.32	6.13	\$75.09
West Virginia (1)	\$1,081.91	1.81	\$597.74
Wisconsin	\$435.05	5.47	\$79.53
TOTAL U.S. (\$US)	\$45,290.57	259.19	\$174.74

Notes: Results are unofficial and unaudited

* FY ends 3/31

** FY ends 8/31

*** FY ends 9/30

**** FY ends 12/31

(1) Includes net VLT sales (Cash in less cash out)

(2) Includes gross VLT sales (Cash in)

(3) Source - US Data: US Census Bureau
estimated July 1, 2003 population

Compiled by the North American Association of State & Provincial Lotteries.

United States Lotteries Ranked by Sales % Growth

Rank	Lottery Jurisdiction	FY02 Sales (millions)	FY03 Sales (millions)	Growth FY03 vs. FY02
1	South Carolina	\$319.99	\$724.31	126.35%
2	West Virginia (1)	\$848.63	\$1,081.91	27.49%
3	Florida	\$2,330.36	\$2,867.98	23.07%
4	Missouri	\$585.19	\$708.57	21.08%
5	New York *	\$4,753.62	\$5,395.96	13.51%
6	District of Columbia ***	\$211.12	\$237.63	12.56%
7	Kansas	\$190.08	\$210.83	10.92%
8	Pennsylvania	\$1,934.16	\$2,132.98	10.28%
9	Rhode Island (2)	\$1,171.10	\$1,290.50	10.20%
10	Nebraska	\$73.91	\$80.92	9.48%
11	Arizona	\$294.82	\$322.28	9.31%
12	Georgia	\$2,449.36	\$2,604.41	6.33%
13	Indiana	\$626.30	\$664.42	6.09%
14	Idaho	\$92.67	\$97.97	5.72%
15	Michigan ***	\$1,688.04	\$1,783.38	5.65%
16	Texas **	\$2,966.27	\$3,130.69	5.54%
17	Kentucky	\$638.72	\$673.49	5.44%
18	Washington	\$438.61	\$460.32	4.95%
19	Ohio	\$1,983.11	\$2,078.20	4.79%
20	Oregon (1)	\$816.94	\$853.16	4.43%
21	Maine	\$157.90	\$164.60	4.24%
22	New Hampshire	\$212.90	\$221.23	3.91%
23	Iowa	\$181.22	\$187.83	3.65%
24	Montana	\$33.63	\$34.68	3.12%
25	South Dakota (2)	\$629.96	\$646.95	2.70%
26	New Mexico	\$133.97	\$137.33	2.51%
27	Virginia	\$1,108.07	\$1,135.72	2.50%
28	Wisconsin	\$427.57	\$435.05	1.75%
29	Maryland	\$1,306.55	\$1,322.60	1.23%
30	New Jersey	\$2,068.52	\$2,074.07	0.27%
31	Louisiana	\$311.62	\$311.46	-0.05%
32	Illinois	\$1,590.15	\$1,585.62	-0.28%
33	Massachusetts	\$4,213.22	\$4,197.75	-0.37%
34	Vermont	\$81.99	\$79.50	-3.04%
35	Colorado	\$407.94	\$391.53	-4.02%
36	California	\$2,917.01	\$2,781.57	-4.64%
37	Connecticut	\$907.90	\$865.29	-4.69%
38	Minnesota	\$377.13	\$351.82	-6.71%
39	Delaware (1)	\$674.01	\$628.06	-6.82%
TOTAL U.S. (\$US)		\$42,421.66	\$45,290.57	6.76%

Notes: Results are unofficial and unaudited

* FY ends 3/31

** FY ends 8/31

*** FY ends 9/30

**** FY ends 12/31

(1) Includes net VLT sales (Cash in less cash out)

(2) Includes gross VLT sales (Cash in)

Compiled by the North American Association of State & Provincial Lotteries.

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SUPPLEMENTARY INFORMATION



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

To the Missouri State Lottery Commission:

We have audited the basic financial statements of the Missouri State Lottery Commission as of and for the year ended June 30, 2004, and have issued our report thereon dated September 24, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Missouri State Lottery Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected with in a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Missouri State Lottery Commission's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of management and the Missouri State Lottery Commission and is not intended to be and should not be used by anyone other than these specified parties.

Berberich Trahan & Co., P.A.

Cochran, Head & Co., P.C.

September 24, 2004

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